

WATER/KPC/KOK/DLW/RHG

Decision _____

**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF
CALIFORNIA**

In the Matter of the Application of SUBURBAN
WATER SYSTEMS U-391-W for Authority to
issue, sell, and deliver its Series E First Mortgage
Bonds not exceeding \$10,000,000 principal
amount.

Application 06-08-015
(Filed August 16, 2006)

OPINION GRANTING AUTHORITY TO ISSUE DEBT SECURITIES

1. Summary

This decision grants Suburban Water Systems (Suburban) the authority requested in Application (A.) 06-08-015 (Application).

Suburban requests authority, pursuant to §§ 816, 817, and 851 of the California Public Utilities (Pub. Util.) Code and Rules 16, 33 and 34 of the Commission's Rules of Practice and Procedure to:

1. Issue, sell and deliver for cash up to \$10,000,000 Series E First Mortgage Bonds due October 20, 2026 (Series E Bonds);
2. Execute a Fifth Amendment and Supplement to its existing Indenture of Mortgage and Deed of Trust; and
3. Be exempted from the Commission's Competitive Bidding Rule in relation to the proposed Series E Bonds.

2. Background

Suburban is a California public utility corporation engaged in the business of providing water service to an area covering approximately forty-three square miles in Orange and Los Angeles counties, comprising all or part of all of the cities of Glendora, Covina, West Covina, Walnut, La Puente, Hacienda Heights, City of Industry, Whittier, La Mirada, La Habra, Buena Park, and other unincorporated areas. Suburban is a wholly owned subsidiary of Southwest Water Company.

For the twelve months ending December 31, 2005, Suburban reported total operating revenues of \$45,826,000 and net income of \$7,582,000, as shown in its Consolidated Statement of Income and Retained Earnings, attached as Exhibit A to the Application. The ending retained earnings amounted to \$37,501,000.

Suburban's Consolidated Balance Sheet at December 31, 2005,
shown also as part of Exhibit A, is summarized as follows:

(Dollars in thousands)

<u>Assets</u>	<u>Amount</u>
Net Property, Plant and Equipment	\$ 98,644
Current Assets	18,746
Other Assets	<u>4,446</u>
Total Assets	<u>\$121,836</u>
<u>Capitalization and Liabilities</u>	
Cumulative Preferred Shares	\$ 3,982
Common Shares	745
Paid In Capital	5,017
Retained Earnings	<u>37,501</u>
Total Stockholders' Equity	\$ 47,245
Current Liabilities	\$ 16,337
Long-Term Debt	23,000
Advances for Construction	5,754
Contributions in Aid of Construction	14,927
Developer Deposits	1,292
Deferred Income Taxes	11,540
Other Liabilities and Deferred Credits	<u>1,741</u>
Total Liabilities	\$ 74,591
Total Commitments and Contingencies	<u>\$121,836</u>

3. Notice and Protests

Notice of the filing of the Application appeared on the Commission's Daily Calendar of August 21, 2006. No protests have been received.

4. Description of Series E First Mortgage Bonds

Suburban seeks authorization to obtain debt capital in an aggregate principal amount not to exceed \$10,000,000 through the issuance and sale of Series E Bonds.

Suburban has not, at the present time, entered into any contract for the purchase and sale of its Series E Bonds but plans to place them privately with one or more institutional investors. Because of changing market conditions, Suburban requests Commission authority to offer, issue and deliver Series E Bonds with interest rates based on market conditions existing at the time of negotiating the terms.

In 1986, Suburban issued \$15,000,000 of 8.93% Series A First Mortgage Bonds, due 2006, pursuant to an Indenture of Mortgage and Deed of Trust (Mortgage Indenture). The remaining outstanding amount of \$3,300,000 was redeemed, on December 1, 2004, at par plus a small call premium.¹

In 1992, Suburban issued \$8,000,000 of 9.09% Series B First Mortgage Bonds, due 2022, pursuant to a Second Amendment and Supplement to the Mortgage Indenture, of which \$8,000,000 is still outstanding.²

In 1996, Suburban issued \$8,000,000 of 7.61% Series C First Mortgage Bonds, due 2006, pursuant to a Third Amendment and Supplement to the Mortgage Indenture, of which \$8,000,000 is still outstanding.³

In 2004, Suburban issued \$15,000,000 of 5.64% Series D First Mortgage Bonds, due 2024, pursuant to a Fourth Amendment and

¹ Authorized by Decision (D.) 86-11-013.

² Authorized by D.92-01-026.

³ Authorized by D.96-10-032.

Supplement to the Mortgage Indenture, of which \$15,000,000 is still outstanding.⁴

The proposed issuance of Series E Bonds will represent the fifth series of First Mortgage Bonds issued by Suburban. They will be direct obligations of Suburban and will rank *pari passu* or equally without preference, with other First Mortgage Bonds of Suburban issued under the Indenture. The interest payments will be semi-annual.

The Series E Bonds are redeemable prior to maturity, in whole or in part, (a) at the option of Suburban at any time on not more than sixty and not less than thirty days prior notice, at par plus accrued interest, plus the Make-Whole Amount, if any, and (b) upon receipt of proceeds equal to or exceeding \$10,000,000 by the trustee under the Indenture as a result of a casualty or condemnation, at the option of Suburban at par plus accrued interest, without the Make-Whole Amount.⁵

Suburban states in the Application that the Bond Purchase Agreement will contain provisions similar to the Bond Purchase Agreement dated as of October 20, 2004 between Suburban and the Purchaser named therein for the Company's 5.64% Series D First Mortgage Bonds. The Bond Purchase Agreement will also include appropriate modernization adjustments pertaining to changes in law or practice, in Private Placement Enhancement Project Model Form No. 2 (Model Form) and other appropriate provisions for the Series E Bonds.

⁴ Authorized by D.04-04-051.

⁵ The Make-Whole Amount is anticipated to be the excess amount of the discounted value of the remaining scheduled payments for the principal called for redemption over the amount of such called principal. The Make-Whole Amount may in no event be less than zero. For purposes of the discounted value, the rate is anticipated to be equal to the interpolated yield of a U.S. Treasury security with maturity equal to the remaining life of the called bonds plus 50 basis points.

The Fifth Amendment and Supplement to Suburban's existing Indenture of Mortgage and Deed of Trust will contain similar provisions to the provisions contained in the Fourth Amendment and Supplement to Indenture dated October 20, 2004 pursuant to which the Series D Bonds of the Company were issued, with some modernization adjustments from the Model Form and other appropriate provisions for the issuance of the Series E Bonds.

5. Use of Proceeds

Suburban intends to apply the net proceeds from the proposed issue of the Series E Bonds: (i) to refinance the \$8,000,000 of Suburban's outstanding 7.61% Series C First Mortgage Bonds that are due in 2006 and (ii) to finance a portion of Suburban's capital expenditure program from 2006 through 2011. Suburban's use of proceeds falls within the purview of § 817(b), (c), (d), and (g).

a) Retirement of Bonds

While using \$8,000,000 of the Series E Bonds to retire the Series C Bonds, which are due in 2006 is a proper use of funds, pursuant to § 817(g), debt costs are normally subject to review in cost of capital or general rate case proceedings. Therefore, we will not make a finding in this decision on the reasonableness of the debt costs for ratemaking purposes.

b) Construction Budget

Suburban's projected construction budgets for 2006 through 2011, as shown in Exhibit E to the Application, are as follows:

<u>Components</u>	(Dollars in thousands)						<u>Total</u>
	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	
New Wells and Supply	500	1,400	1,400	1,400	1,400	1,400	7,500
Reservoir Improvements	1,515	2,865	1,000	1,000	1,000	1,000	8,380
Pumps and Equipment	2,800	450	1,800	1,800	1,800	1,800	10,450
Transmission & Distribution							
Main Replacements	345	360	390	390	390	390	2,265
New Transmission & Distribution Mains	0	1,100	1,700	1,700	1,700	1,700	7,900
Other	<u>1,205</u>	<u>1,060</u>	<u>1,060</u>	<u>1,060</u>	<u>1,060</u>	<u>1,060</u>	<u>6,505</u>
Total Capital Expenditures	<u>6,365</u>	<u>7,235</u>	<u>7,350</u>	<u>7,350</u>	<u>7,350</u>	<u>7,350</u>	<u>43,000</u>

Suburban's water system was built between 1940 and 1950. The projected capital expenditures are for infrastructure replacement. Suburban does not have any existing citations from or mandated requirements by the state Department of Health Services.

While the construction, extension or improvement of a company's facilities are proper uses for financing authority, pursuant to § 817(b) and (c), we will not make a finding in this decision on the reasonableness of Suburban's proposed construction program. Construction expenditures and the resulting plant balances in rate base are issues that are normally addressed in general rate cases.

6. Cash Requirements Forecast

Suburban's estimate of cash requirements for 2006 through 2011 is summarized as follows:

(Dollars in thousands)

<u>Components</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>Total</u>
Construction Expenditures	6,365	7,235	7,350	7,350	7,350	7,350	43,000
Repayment of Series C Bonds	<u>8,000</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>8,000</u>
Subtotal	14,365	7,235	7,350	7,350	7,350	7,350	51,000
Less:							
Estimated Cash Provided from Internal Sources and Short Term Borrowing	(6,129)	(6,156)	(6,751)	(7,014)	(7,277)	(7,541)	(40,868)
External funding required	<u>8,236</u>	<u>1,079</u>	<u>599</u>	<u>336</u>	<u>73</u>	<u>(191)</u>	<u>10,132</u>
% of Available Cash to Needed Funds	43%	85%	92%	95%	99%	103%	80%

Suburban's projected cash requirements indicates that internally generated funds will provide approximately \$40,868,000 or 80% of its total cash requirements of \$51,000,000 for years 2006 through 2011. The requested \$10 million debt issue appears necessary to help Suburban meet its \$10,132,000 external funds requirements.

7. Capital Structure

Suburban's capital ratios as of March 31, 2006, are presented below as recorded and adjusted to give pro forma effect to the transactions listed below:

	(Dollars in thousands)				
	<u>Recorded</u>		<u>Adjustments</u>	<u>Proforma</u>	
Long-term debt	31,000	39.6%	2,000	33,000	36.1%
Short-term debt	<u>0</u>	<u>0.0%</u>	<u>-</u>	<u>0</u>	<u>0.0%</u>
Total Debt	31,000	39.6%	2,000	33,000	36.1%
Preferred Stock	3,982	5.1%	-	3,982	4.4%
Common Equity	<u>43,265</u>	<u>55.3%</u>	<u>11,118</u>	<u>54,383</u>	<u>59.5%</u>
Total Equity	47,247	60.4%	11,118	58,365	63.9%
Total Capitalization	<u>78,247</u>	<u>100.0%</u>	<u>13,118</u>	<u>91,365</u>	<u>100.0%</u>

Explanation of Adjustments:

a) Debt Securities

1. The proposed issue of Series E Bonds in the amount of \$10,000,000.
2. The planned refinancing of \$8,000,000 First Mortgage Bonds, Series C issued under D.96-10-032.
3. Estimated long-term debt at 6/30/06 is \$31,000,000.
4. The net of these transactions is a \$2,000,000 increase in debt.

b) Equity Securities

1. The projected increase in retained earnings of \$11,117,738 is estimated to occur in 2006 through 2011.

Suburban's authorized capital structure for Test Year 2006/2007, shown as part of Appendix A to D.06-08-017 dated August 24, 2006,

consists of 41.2% long-term debt, 4.5% preferred equity, and 54.3% common equity.

While it appears that approving Suburban's financing request will not materially change Suburban's capital structure to the detriment of ratepayers, capital structures are normally subject to review in cost of capital or general rate case proceedings. We will not, therefore, make a finding in this decision of the reasonableness of the projected capital ratios for ratemaking purposes.

We remind Suburban that in exercising its authorized debt financings, including any existing authorizations, as well as the current debt authority, it shall endeavor to rebalance its capital structure to authorized levels to ensure that the resulting capital structure is in compliance with its most currently authorized capital structure.

8. Debt Approval

Pursuant to § 818, we will authorize Suburban's proposed issue of Series E Bonds in the aggregate principal amount of \$10,000,000. Pursuant to § 851, we will allow Suburban to execute the Fifth Amendment and Supplement to its existing Indenture of Mortgage and Deed of Trust and the Bond Purchase Agreement.

Section § 817(b) allows a public utility to issue stocks or evidences of indebtedness payable at a period of more than 12 months for the construction, completion, extension, or improvement of its facilities. The use of proceeds for improvement or maintenance of service, lawful refunding of obligations, and retirement or exchange of indebtedness are also permitted under § 817(c), (d), and (g), respectively.

Our authorization is not to be construed as a finding of the value of Suburban's stock or properties nor as indicative of the amounts to be

included in proceedings for the determination of just and reasonable rates. Consistent with § 824, Suburban shall maintain records to (i) identify the specific long-term debt issued pursuant to this order, and (ii) demonstrate that the proceeds from such debt have been used only for the purposes authorized by this order.

9. Competitive Bidding Rule

Under the provisions of Resolution (Res.) No. F-616, Suburban's proposed issue and sale of Series E Bonds is exempt from the Commission's Competitive Bidding Rule because the principal amount does not exceed \$20,000,000.

10. Categorization and Need for Hearings

In Res. ALJ 176-3177, dated August 24, 2006, the Commission preliminarily categorized this Application as ratesetting, and preliminarily determined that hearings were not necessary. No protests have been received. Given these developments, a public hearing is not necessary, and there is no need to alter the preliminary determinations made in Res. ALJ 176-3177.⁶

11. Comments on Proposed Decision

This is an uncontested matter in which the decision grants the relief requested. Accordingly, pursuant to § 311(g)(2), the otherwise applicable 30-day period for public review and comment is being waived.

12. Fees

Whenever the Commission authorizes a utility to issue debt, the Commission is required to charge and collect a fee in accordance with

⁶ On August 16, 2006, Suburban filed a Motion requesting expeditious treatment of its Application. On August 30, 2006, Suburban withdrew this Motion. We grant the request to withdraw the Motion.

§ 1904(b). Section 1904(b) states that no fee need be paid on such portion of any such issue as may be used to guarantee, take over, refund, discharge, or retire any stock, bond, note or other evidence of indebtedness on which a fee has been paid to the Commission. On August 18, 2006, Suburban paid the fee of \$3,000.⁷

13. Assignment of Proceeding

Kevin P. Coughlan is the assigned Examiner in this proceeding.

Findings of Fact

1. Suburban, a California corporation, is a water utility subject to the jurisdiction of this Commission.

2. Suburban needs external funds for the purposes set forth in the Application.

3. The money, property, or labor to be procured or paid for by the proposed debt issue is reasonably required for the purposes specified in the Application.

4. Authorizing Suburban to offer, issue and deliver the Series E Bonds with interest rates based on existing market conditions at the time of negotiating the terms as set forth in the Application would not be adverse to the public interest.

5. Authorizing Suburban to encumber utility assets in the event that such encumbrance will be required to secure the debt issue is for proper purposes and is not adverse to the public interest.

6. Res. No. F-616 specifically exempts debt issues of \$20,000,000 or less from the Competitive Bidding Rule.

⁷ The amount subject to the fee is \$2,000,000 (\$10,000,000 less \$8,000,000 to be used for refinancing). The fee is determined as follows: $(\$2 \times (1,000,000/1,000)) + (\$1 \times 1,000,000/1,000) = \$3,000$.

7. The reasonableness of any resulting construction expenditures, capital structure, interest rate and cost of money arising from debt capital is subject to review in cost of capital or general rate case proceedings.

8. Suburban has paid the fee of \$3,000 required by § 1904(b).

9. Notice of the filing of the Application appeared on the Commission's Daily Calendar of August 21, 2006. There is no known opposition to this Application, and the authority requested should be granted.

Conclusions of Law

1. A public hearing is not necessary.

2. The Application should be granted to the extent set forth in the order that follows.

3. This authorization is not a finding of the value of Suburban's stock or property, nor does it indicate approval of matters subject to review in cost of capital or ratemaking proceedings.

4. Suburban is exempt from the Competitive Bidding Rule because the proposed debt issue does not exceed \$20,000,000.

5. Section 818 requires Commission authorization for the issue of stocks, bonds, notes, or other evidences of indebtedness payable at periods of more than 12 months.

6. Section 1904(b) provides that no fee need be paid on such portion of any such issue as may be used to guarantee, take over, refund, discharge, or retire any stock, bond, note or other evidence of indebtedness on which a fee has already been paid to the Commission.

7. The following order should be effective on the date of signature.

ORDER

IT IS ORDERED that:

1. On or after the effective date of this order, Suburban Water Systems (Suburban), upon terms and conditions substantially consistent with those set forth or contemplated in Application 06-08-015 (Application), is authorized to:
 - a) Issue, sell, and deliver for cash up to \$10,000,000 aggregate principal amount of its Series E First Mortgage Bonds (Series E Bonds) due October 20, 2026; and
 - b) Execute and deliver any and all related documents required for the completion of the proposed financing, including, without limitation, the Fifth Amendment and Supplement of its existing Indenture of Mortgage and Deed of Trust and the proposed Bond Purchase Agreement.
2. Suburban shall apply the proceeds of the Series E Bonds authorized for the purposes specified in their Application and discussed in this decision.
3. Suburban's proposed issuance and sale of Series E Bonds is exempted from the requirements of the Commission's Competitive Bidding Rule.
4. Suburban shall maintain records to (i) identify the specific long-term debt issued pursuant to this order, and (ii) demonstrate that the proceeds from such debt have been used only for the purposes authorized by this order.
5. Suburban shall keep and maintain copies of the agreements for the sale of the Series E Bonds and the final Fifth Supplemental Indenture,

and within thirty days from request provide copies to the Water Division's Utility Audit, Finance and Compliance Branch (UAFCB).

6. On or before the 25th day of each month, Suburban shall file with the Water Division's UAFCB the reports required by General Order Series 24.

7. The Application is granted as set forth above.

8. Application 06-08-015 is closed.

This order is effective today.

Dated _____, at San Francisco, California.